NO. 84-629

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

ERNEST M. McCOLLUM, and
SMITH BARNEY, HARRIS, UPHAM & CO., INC.,
Respondents.

On Writ Of Certiorari
To The Supreme Court Of Texas

PETITIONER'S REPLY BRIEF IN RESPONSE TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. DOES SECTION 3 OF THE FEDERAL ARBITRATION ACT, 9 U.S.C. § 1, *ET SEQ.*, WHICH SETS OUT PROCEDURES FOR ENFORCEMENT OF THE FEDERAL SUBSTANTIVE RIGHTS CREATED BY THE ACT, APPLY IN THIS STATE COURT PROCEEDING?

2. IF SECTION 3 OF THE FEDERAL ARBITRATION ACT, 9 U.S.C. § 1, *ET SEQ.*, IS NOT APPLICABLE IN THIS PROCEEDING, DOES THE PROCEDURE PROVIDED FOR BY TEXAS LAW IN ENFORCING ARBITRATION AGREEMENTS INSOFAR AS THAT PROCEDURE MAKES AVAILABLE TEMPORARY INJUNCTIVE RELIEF PENDING ARBITRATION VIOLATE THE FEDERAL SUBSTANTIVE POLICIES UNDERLYING THE ACT?

3. IF SECTION 3 OF THE FEDERAL ARBITRATION ACT, 9 U.S.C. § 1, *ET SEQ.*, IS APPLICABLE IN THIS PROCEEDING, DID THE COURTS BELOW PROPERLY CONSTRUE SECTION 3 OF THE ACT TO PRECLUDE ISSUANCE BY THE TRIAL COURT OF A TEMPORARY INJUNCTION PENDING ARBITRATION OF THE ISSUES IN DISPUTE?

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To The Honorable, The Chief Justice and Associate Justices of the Supreme Court of the United States:

Merrill Lynch, Pierce, Fenner & Smith, Inc.,[1] the petitioner herein, respectfully submits this its Reply Brief to Respondents' Brief in Opposition to Petition for Writ of Certiorari filed herein.

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1. Petitioner Merrill Lynch, Pierce, Fenner & Smith, Inc. is a corporation whose parent company is Merrill Lynch & Co., Inc., and which has no affiliates or subsidiaries, except wholly owned affiliates or subsidiaries.

1. Jurisdiction Under 28 U.S.C. § 1257(3)

Respondents question whether this Court has jurisdiction to issue a Writ of Certiorari to review this case under 28 U.S.C. § 1257(3). Respondents arguments, however, ignore this Court's previous opinions construing this statute.

Petitioner argues in this case that the Texas courts have improperly applied Section 3 of the Federal Arbitration Act to the facts of this case, or in the alternative, that the Texas courts have misconstrued Section 3. This Court has recognized its certiorari jurisdiction in cases where the question of the applicability of a federal statute to the facts of the case is in issue. *See Fischer v. Pauline Oil & Gas Co.*, 309 U.S. 294, 295-6 (1940); *see also* 12 Moore's Federal Practice ¶513.01 (2d ed. 1981). This Court has also recognized that a question concerning the proper interpretation of federal law is a proper subject of review on certiorari under 28 U.S.C. § 1257(3). *See Kulko v. Superior Court of California in and for City and County of San Francisco*, 436 U.S. 84, 90, fn.4 (1978). Accordingly, this Court has jurisdiction to review this case under 28 U.S.C. § 1257(3).

2. Independent and Adequate State Grounds

Respondent argues that an adequate and independent state ground exists for the decision below. These arguments are based on Respondents' construction of the Texas General Arbitration Act, Tex. Rev. Civ. Stat. Ann. art. 224 *et seq.* (Vernon 1973 and Supp. 1984). Respondents construe that statute to withdraw the power of a Texas trial court to issue a temporary injunction pending arbitration, independent of Section 3 of the Federal Arbitration Act.

The short answer to Respondents' arguments in this regard is that the "plain statement" rule enunciated by this Court in *Michigan v. Long*, ____U.S.____, 103 S.Ct. 3469, 3475 (1983) for determining whether an independent and adequate state ground exists, has not been satisfied in this case. *Long* requires that the adequacy and independence of any possible state law ground for the decision be made clear from the face of the state court's opinion. *Id.* at 3475. In the case *sub judice*, the decision below rested solely on the court's interpretation of the Federal Arbitration Act, and there is no indication whatsoever from the opinion rendered that the court was relying on any independent and adequate state ground for its decision.[2] In fact, Respondents admit in their Brief in Opposition filed herein that the asserted "state grounds have not been articulated in the trial courts' orders and the Court of Appeals' opinion."[3] There is no independent and adequate state ground for the decision below under the test enunciated by this Court in *Long*.

Even if a *possible* independent and adequate state ground was sufficient to remove this Court's jurisdiction, there is no such possible ground in this case. Tex. Rev. Civ. Stat. Ann. art. 235(G) was added by the drafters of the Texas General Arbitration Act for the express purpose of making certain that the Texas courts retained their equitable powers in connection with arbitrable disputes. Carrington, *The 1965 General Arbitration Statute of Texas*, 20 Sw. L.J. 21, 30 (1966). Article 235(G) of the Texas Act is a supplement to Article 225 of that Act, and is not displaced by Article 225 as contended

2. *See* Appendix B to Petition for Writ of Certiorari.

3. Respondents' Brief at 11.

by Respondents. Respondents' construction of the Texas statute would make Article 235(G) meaningless.

Although many additional arguments could be advanced in response to Respondents' contentions concerning the proper interpretation of the Texas General Arbitration Act, Petitioner is unable to do so in this Reply Brief due to space limitations.

3. Mootness

Respondent argues that because Petitioner requested injunctive relief only through August 9, 1984, its claim for such relief is now moot. Petitioner's claim for relief is so limited because the contractual provision at issue in this dispute (which prohibits certain post-employment activities by Respondent McCollum) only applies for a period of one year after termination. This contractual provision is a standard provision which appears in the employment contracts of hundreds of other account executives employed by Petitioner nationwide.

Petitioner respectfully submits that this case is "capable of repetition, yet evading review," and therefore falls within an established exception to the mootness doctrine. As stated by this Court in *Weinstein v. Bradford*, 423 U.S. 147, 149 (1975), the "capable of repetition, yet evading review" doctrine is applicable where two elements combine: "(1) the challenged action was in its duration too short to be fully litigated prior to its cessation or expiration, and (2) there was a reasonable expectation that the same complaining party would be subjected to the same action again." With respect to the first element, due to the fact that the contractual limitation on Respondent McCollum's activities was limited to a one year

period beginning on the date of his termination of employment with Petitioner, the trial court's decision whether or not to grant injunctive relief has no practical effect beyond the one year contractual period. Because denial by the trial court in the case *sub judice* would not affect either Petitioner or Respondents beyond this one year period, and because the one year period is too short to complete judicial review of the issues presented to this Court in this case, the first element of the *Weinstein* test is satisfied.

With respect to the second element, there is more than a "reasonable expectation" that Petitioner will be subjected to the same action again. In fact, a case involving the same fact situation and identical legal issues is currently pending in the First Court of Appeals of Texas, styled *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Maghsoudi*, No. 01-84-00153-CV. Although that case is still pending on rehearing, the Court of Appeals has rendered an opinion on the original hearing holding that the decision of the state courts in the case *sub judice* is controlling on the question whether a trial court has the power to issue temporary injunctive relief pending arbitration.[4] Furthermore, it is reasonable to expect that the same fact situation and issues will arise again, as the contracts of hundreds of account executives employed by Petitioner have the same contractual provisions as the contract involved in this case. There is "a reasonable expectation that [Petitioner will] be subjected to the same action again," and both elements of the "capable of repetition, yet evading review" exception to the mootness doctrine are present in this case. *Cf. Moore v. Ogilvie*, 394 U.S. 814 (1969).

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4. *See* Appendix A hereto.

4. The Merits

Although Respondents' Brief in Opposition is limited primarily to the jurisdictional arguments replied to above, Respondents also have attempted to respond to the Petition for Writ of Certiorari on the merits.

With respect to the issue of the applicability of Section 3 of the Federal Arbitration Act in state court proceedings, Respondents argue that Section 2 of the Act, which this Court in *Southland Corp. v. Keating*, ____U.S.____, 104 S.Ct. 852 (1984) held to create federal substantive rights applicable in both state and federal courts, would be "meaningless" if Section 3 of the Act is not applicable in state courts.[5] The fallacy in this argument, however, is demonstrated by Respondents themselves, as they state in their Brief in Opposition (in connection with their independent and adequate state ground arguments) that the Texas procedures for enforcement of arbitration agreements are even more protective of the substantive rights created by Section 2 than is Section 3.[6] While this argument erroneously construes Texas law to prevent temporary injunctive relief pending arbitration, it illustrates that state procedure *can* be used to enforce arbitration agreements and adequately protect the federal substantive rights created by Section 2 of the Act. While it is true that this Court stated in *Bernhardt v. Polygraphic Company of America*, 350 U.S. 198, 201 (1956) that "Sections 1, 2 and 3 [of the Act] are integral parts of a whole," this was simply a recognition that federal rights have no meaning unless there is a means for vindication of those rights. State procedural law, equally as well as federal

5. Respondents' Brief at 6.

6. Respondents' Brief at 10.

procedural law, can provide the means for vindication of the substantive rights created in Section 2 of the Act.

Respondents also cite numerous cases in which Petitioner was a party which Respondents assert have rejected the arguments asserted by Petitioner herein.[7] While it is true that the federal court cases cited by Respondents have rejected Petitioner's interpretation of Section 3, none of those cases are from courts in the Seventh or Second Circuits, which have held that temporary injunctive relief is available pending arbitration. *See Erving v. Virginia Squires Basketball Club*, 468 F.2d 1064 (2d Cir. 1972); *Sauer-Getriebe KG v. White Hydraulics, Inc.*, 715 F.2d 348 (7th Cir. 1983). With respect to the state court cases cited by Respondents, all but two of those cases are merely unreported state trial court orders. These unreported orders either (1) state no basis for the order, (2) rely on Section 3 of the Act, or (3) rely on particular state procedural rules for rejection of the temporary injunctive relief requested. None of these cases address the question whether *Texas* law allows temporary injunctive relief pending arbitration, or whether such relief impairs the substantive rights created by Section 2 of the Act. Furthermore, these cases illustrate the confusion which currently exists in the state courts as to the proper procedural law to be applied.

Of the two reported state cases cited by Respondents, *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ray*, 439 So.2d 442 (La. 1983), is merely a summary affirmance without opinion of an unreported trial court order denying a temporary injunction based on Section 3 of the Act. *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Maghsoudi*, ____S.W.2d____ (Tex. App.—Houston [1st Dist.] Octo-

7. Respondents' Brief at 12-13.

ber 11, 1984), which is still pending on rehearing, merely follows the decision of the lower courts in the case *sub judice*.[8] Respondent understandably fails to cite *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. District Court, City and County of Denver,* 672 P.2d 1015 (Colo. 1983), in which the Colorado Supreme Court held, in a case indistinguishable from the case at bar, that temporary injunctive relief pending arbitration is available.

As can be seen, there is no "clearly delineated and workable body of jurisprudence"[9] which would be disrupted if this Court sustained Petitioner's arguments herein, and no "chaotic judicial diseconomy"[10] would result therefrom.

Respondents also argue that temporary injunctive relief pending arbitration is inconsistent with the Congressional purpose in enacting Section 3 of the Federal Arbitration Act.[11] Respondents point to the statement in *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, ____ U.S.____, 103 S.Ct. 927, 940 (1983) that "Congress' clear intent in the Arbitration Act [was] to move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible."

Petitioner has two responses to this argument. First, the availability of temporary injunctive relief pending arbitration does not stand as a significant obstacle to Congress' purpose to "move the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." Upon a determination of arbitrability,

8. *See* Appendix A hereto.

9. Respondents' Brief at 13.

10. Respondents' Brief at 13.

11. Respondents' Brief at 13.

the court action is stayed and cannot proceed to final resolution in the trial court. The trial court would merely retain jurisdiction to issue orders in aid of the arbitration, including the power to issue temporary injunctive relief pending final resolution of the dispute in arbitration, to preserve the status quo and prevent irreparable harm, which harm could not be compensated for by way of damages in arbitration. The temporary injunction hearing, by its very nature, is an expedited proceeding, and would not result in significant delay in the parties' moving out of court and into arbitration for all purposes.

Nevertheless, even if the availability of temporary injunctive relief pending arbitration was inconsistent with Congress' purpose behind Section 3 of the Act, that purpose is not relevant to the determination whether *Texas* procedures, which allow temporary injunctive relief pending arbitration, impair the *substantive* rights created in Section 2 of the Act. It is clear, and Respondents admit,[12] that the Congressional intent to move the parties out of court and into arbitration as quickly as possible is the intent behind *Section 3* of the Act. Section 3 is a procedural provision which pursuant to Congress' express mandate applies only in the federal courts. *See Southland Corp. v. Keating,* 104 S.Ct. at 868 (O'Connor, J., dissenting). Because Section 3 of the Federal Arbitration Act is merely a procedural provision which has no application in the state courts, the Congressional purpose behind Section 3 is simply irrelevant to the determination whether the Texas procedures making available temporary injunctive relief pending arbitration impair the *substantive* rights created in Section 2 of the Act.

12. Respondents' Brief at 13.

Contrary to Respondents' assertions, Petitioner does not ask this Court "to make a radical departure from [the] established principles of arbitration jurisprudence"[13] established by this Court in *Southland* and *Moses H. Cone*. Petitioner merely asks this Court to address the question reserved in *Southland* whether Section 3 of the Federal Arbitration Act applies in state court proceedings and to resolve the uncertainty and confusion currently existing in the courts concerning the availability of temporary injunctive relief pending final resolution *in arbitration* of a dispute arbitrable under the Federal Arbitration Act.

CONCLUSION

For the foregoing reasons, and the reasons stated in the Petition for Writ of Certiorari previously filed herein, the Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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November 19, 1984

13. Respondents' Brief at 5-6.

CERTIFICATE OF SERVICE

I, Kenneth E. Johns, Jr., a member of the Bar of the Supreme Court of the United States and counsel of record for Merril Lynch, Pierce, Fenner & Smith, Inc., Petitioner herein, hereby certify that on November ——, 1984, pursuant to Rule 28, Rules of the Supreme Court, I served three copies of the above and foregoing Petitioner's Reply Brief in response to Respondents' Brief in Opposition to Petition For Writ Of Certiorari To The Supreme Court Of Texas on each of the parties herein, as follows:

On Ernest M. McCollum and Smith Barney, Harris, Upham & Co., Inc., Respondents herein, by depositing such copies in the United States Post Office, Houston, Texas, with first class postage prepaid, properly addressed to the post office address of Mark C. Watler, the above-named Respondents' counsel of record, at Woodard, Hall & Primm, 4700 Texas Commerce Tower, Houston, Texas 77002.

All parties required to be served have been served.

Dated November 19, 1984.

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APPENDIX A

COURT OF APPEALS
First Supreme Judicial District

No. 01-84-0153-CV

MERRILL LYNCH, PIERCE, FENNER AND SMITH,
Appellant

v.

ABRAHAM MAGHSOUDI AND
PRUDENTIAL-BACHE SECURITIES, INC.,
Appellees

On Appeal from the 281st Judicial District Court
of Harris County, Texas
Trial Court Cause No. 84-99663

OPINION

Merrill Lynch, Pierce, Fenner and Smith sued Abraham Maghsoudi and Prudential-Bache Securities, Inc., seeking damages and injunctive relief under theories of: (1) breach of contract, (2) illegal use of appellant's trade secrets, (3) tortious interference with contractual and business relations, (4) unjust enrichment, and (5) conspiracy. Upon the defendant's motion, the trial court entered an order staying trial proceedings, ordering arbitration, and denying Merrill Lynch's request for injunctive relief. Merrill Lynch appeals these actions.

The defendant Maghsoudi was formerly employed by Merrill Lynch as an account executive. At the time he was hired, he signed a contract in which he agreed that, in the event of his termination, he would not remove the originals or copies of Merrill Lynch's records and would not, for a period of one year thereafter, solicit its cus-

tomers he had come to know while in its employ. The contract also contained the following provision relating to arbitration of disputes:

> I agree that any controversy between myself and Merrill Lynch arising out of my employment, or the termination of my employment, with Merrill Lynch for any reason whatsoever shall be settled by arbitration at the request of either party in accordance with the Constitution and Rules of the New York Stock Exchange, then in effect.

Maghsoudi subsequently resigned from Merrill Lynch and began working for Prudential-Bache. Merrill Lynch's petition alleges that Maghsoudi solicited its customers and removed its records in contravention of the employment contract and that these acts were done with the knowledge and encouragement of Prudential-Bache.

The trial court denied appellant's requested relief and ordered the parties to proceed to arbitration on the basis of the Federal Arbitration Act, 9 U.S.C. (1976). Sections 3 and 4 of that Act provide:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration. . . . The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply

> therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement.

Merrill Lynch brings twelve points of error, making arguments that were recently urged and rejected in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. McCollum*, 666 S.W.2d 604 (Tex. App.—Houston [14th Dist.] 1984, wrti ref'd n.r.e.). These arguments were squarely presented to the Texas Supreme Court in Merrill Lynch's application for writ of error, and that court refused to grant that writ, finding no reversible error. We thus are strongly inclined to follow the *McCollum* decision unless it may be distinguished. *See Culver v. State*, 85 S.W.2d 997 (Tex. Civ. App.—El Paso 1935, no writ).

On oral submission, Merrill Lynch argues that we should not follow the *McCollum* decision because it is still pending on motion for rehearing in the Texas Supreme Court. Merrill Lynch also argues that *McCollum* should be distinguished from the instant case because in *McCollum*, Merrill Lynch made only an "offer of proof", and did not make a full presentation of evidence as it did in the case at bar. Thus, Merrill Lynch asserts that the Texas Supreme Court's denial of its application in *McCollum* could have been predicated upon a finding that the record did not present an adequate evidentiary basis for a review of its points of error.

We disagree with this argument. Under section 3 of the Federal Arbitration Act, the trial court must determine whether the issues presented are "referable to arbitration under the agreement to arbitrate." Absent some showing that the allegations of the suit have been cast in bad faith, this determination is properly made without con-

ducting an evidentiary hearing. *McCollum*, 666 S.W.2d 604.

Merrill Lynch also asserts that important policy considerations require this court to refuse to follow the holding in *McCollum*. Principally, Merrill Lynch urges that the *McCollum* decision, and other authorities to the same effect, will have a disastrous impact on the enforceability of protective covenants, because they will create a void during the period pending arbitration in which the party seeking to enforce the agreement will be denied any effective relief. We have noted, particularly on oral argument, that the parties are in substantial disagreement about the time required to obtain arbitration under the Act and also about preventative remedies that are available during the period pending arbitration. These same policy considerations were presented in *McCollum*, and we find no reason to rule contrary to that decision.

The judgment of the trial court is affirmed.

/s/ FRED V. KLINGEMAN
Fred V. Klingeman
Associate Justice (Retired)

Chief Justice Evans and Associate Justice Warren also sitting.

For Publication.

JUDGMENT RENDERED AND OPINION DELIVERED OCTOBER 11, 1984.

TRUE COPY ATTEST:

/s/ KATHRYN COX
Kathryn Cox
Clerk of the Court